STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 99-851

May 22, 2003

PUBLIC UTILITIES COMMISSION
Investigation into Verizon Maine's
Alternative Form of Regulation

EXAMINER'S REPORT
(POST-REMAND NO. 1)

NOTE: This Examiner's Report contains the recommendation of the Hearing Examiner. Although written in the form of an order, it does not constitute formal Commission action. Parties may file exceptions to this Report on or before **June 10, 2003**. We anticipate that the Commission will consider this Examiner's Report at its Deliberative Session on **June 16, 2003**.

I. SUMMARY

In this Order, we decide, until we complete these proceedings following the remand from the Law Court, that on a temporary basis the various pricing rules and other features of the vacated alternative form of regulation (AFOR) will apply to the regulation of Verizon Maine. We also decide that the increase in local rates of $1.78, ordered on June 1, 2001, for the purpose of offsetting access rate reductions required by law, will continue in effect.

II. PROCEDURAL BACKGROUND

On February 28, 2003, the Maine Supreme Judicial Court, sitting as the Law Court, vacated this Commission's June 25, 2001 AFOR Order (*2001 AFOR Order*) and remanded the case for "further proceedings consistent with this

opinion." *Office of the Public Advocate v. Public Utilities Commission and Verizon New England, Inc*., 2003 ME 23, 816 A.2d 833 (*OPA v. PUC/Verizon* or 2003 ME 23). On March 19, 2003, we issued a Notice of Further Proceedings Following Remand (NFR). The NFR described a number of issues we must consider in order to determine whether to order a continued AFOR for Verizon. The NFR requested the parties to address the two issues we decide in this Order in a first round of briefing. We will address issues concerning a long-term AFOR in a later order.

Verizon Maine (Verizon), the Public Advocate (OPA) filed briefs that addressed both of the issues discussed in this Order. The American Association of Retired Persons (AARP) filed a brief that addressed the local rate issue, but not the interim regulation issue.

III. INTERIM REGULATION

The Law Court "vacated" the AFOR order. As is normal practice for the Court in such cases it stated only: "Order creating the alternative form of regulation vacated. Remanded to the Commission for further proceedings consistent with this opinion." The Court said nothing specific about the form of regulation during the period prior to completion of the proceedings following the remand.

It is clearly necessary, while we consider whether to implement a long-term AFOR, to determine the nature of regulation in the interim. In the NFR, we "tentatively concluded" that Verizon had not "reverted" to the previously existing

AFOR (whether called the "old" AFOR or "phase one" of an ongoing AFOR), but that, in the absence of a validly existing AFOR, Verizon would revert to non-AFOR (i.e., rate of return) regulation under 35-A M.R.S.A. §§ 301-312; 1302-14. We suggested that the AFOR effective between 1995 and 2001 had expired. (The AFOR was originally in effect from December 1, 1995 to November 30, 2000 and was extended by an order in this docket to May 29, 2001.)

The Public Advocate argues that Verizon has in fact reverted to the previously existing AFOR, that the vacation of the order "wipes the slate clean," that the "previously existing status is restored as though the order had never existed," and that "Verizon should be placed back in the position it occupied before the *2001 AFOR Order* was issued, i.e., subject to the terms of the 1995-2001 AFOR." It is not as obvious to us that Verizon necessarily must revert to the most recent form of regulation. We intended that the original AFOR would last for five years, unless renewed (either with or without revisions). Although we attempted to renew it (with revisions), we failed. After the five years (extended by six months), a return to the form of regulation that applies in the absence of an authorized AFOR is at least as logical as the Public Advocate's position.

Verizon states that the Commission "observes" (and Verizon apparently agrees) that Verizon is "now subject to 'normal' regulation under [35-A M.R.S.A.] §§301-312; 1302-14…." It argues:

> Under these statutes, the Commission has broad discretion to fashion the regulatory tools that are appropriate to its oversight of Verizon Maine. The Commission can and should…exercise its

> statutory authority by retaining core principles of the AFOR plan on an interim basis….

Verizon does not state the basis for its conclusion that the statutes governing "normal" regulation provide the Commission with "broad discretion" to implement what in effect amounts to a temporary AFOR. 35-A M.R.S.A. §303 states:

> **§303. Valuation of property for fixing rates**
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> In determining just and reasonable rates, tolls and charges, the commission shall fix a reasonable value upon all the property of a public utility…which is used or required to be used in its service to the public within the State and a fair return on that property. In fixing a reasonable value, the commission shall give due consideration to evidence of the cost of the property when first devoted to public use and the prudent acquisition cost to the utility, less depreciation on each, and any other material and relevant factors or evidence, but the other factors shall not include current value. ….

Although the Commission may have some discretion in fashioning the form of regulation after it determines the value of a utility's property and establishes a reasonable return, the requirements of this statute appear to require a rate base and a rate of return. The statutes governing "normal" regulation do not appear to allow the Commission to establish an alternative form of regulation that departs substantially from "rate base - rate of return" regulation. The fact that the Legislature enacted the AFOR statute, which both expressly authorizes the Commission to implement an AFOR and places limits on that discretion, is one indication that sections 301-312 and 1302-14 do not contain the flexibility argued by Verizon.

We decide that it is not necessary to determine the form of regulation to which Verizon may have "reverted" or whether there is sufficient flexibility under 35-A M.R.S.A. §§ 301-312 and 1302-14 to fashion an interim alternative form of regulation. We conclude that 35-A M.R.S.A. § 104 confirms that we have sufficient authority and discretion to choose among the various alternatives for temporary regulation. 35-A M.R.S.A. § 104 states:

> The provisions of this Title shall be interpreted and construed liberally to accomplish the purpose of this Title. The commission has all implied and inherent powers under this Title, which are necessary and proper to execute faithfully its express powers and functions specified in this Title.

The most fundamental express power and function in Title 35-A is to ensure that a utility's rates are "just and reasonable." Another important power and function is the authority to establish an alternative form of regulation for a telephone utility. 35-A M.R.S.A. §§ 9101-9103. In the course of that second function, it is necessary, because the Commission's Order establishing the 2001-2006 AFOR was vacated by the Law Court, to conduct further, corrective, proceedings. Those proceedings necessarily take some amount of time. During that period of time, a regulatory vacuum is not possible. It would surely be unlawful to have no regulation at all. We find that we inherently have the necessary power to establish a temporary form of regulation in conjunction with our execution of the express powers and functions in Title 35-A to ensure just and reasonable rates and to determine whether to establish an alternative form of regulation.

There are three plausible choices for temporary regulation. One is a return to pre-AFOR "traditional" rate of return (ROR) regulation. Another is to re-implement the AFOR that was in effect from 1995 to May 29, 2001. The third is to require Verizon to adhere to the pricing rules and the SQI of the vacated AFOR.

We reject the first two of these alternatives. We find that it is most reasonable, on an interim basis, to require adherence to the features of the vacated AFOR.

A return to ROR would be a return to a form of regulation that has not applied to Verizon for 7½ years. While little harm may occur in the short run, it would be a return to regulation that we have twice found to be inferior to alternative, incentive regulation. We note that in the short term, there may be little practical difference between a return to ROR and temporary implementation of the vacated AFOR. Under ROR, Verizon could file a rate case under 35-A M.R.S.A. § 307, but the Commission could suspend those rates for investigation. Under the vacated AFOR, Verizon's local rates would be subject to a rate cap and its interexchange rates subject to competitive downward pressures. ROR, however, would not contain other advantages to ratepayers that are included in the vacated AFOR, namely, rate caps for operator and directory assistance services and the incentives for Verizon to ensure quality service contained in the Service Quality Index (SQI).

We also reject re-implementation of the 1995-2001 AFOR because we found in the vacated AFOR order that the degree of regulation that was included in that AFOR was not as necessary for Verizon during the subsequent period. The OPA, on appeal, did not object to that general conclusion. It did not object to any of the changes in pricing rules and other features between the 1995-2001and 2001-2006 AFORs. Instead, the Public Advocate has objected only to the existence of the 2001-2006 AFOR, on the ground that the finding under 35-A M.R.S.A. § 9103(1) was inadequate, and perhaps to its initial price levels, because of the Commission declined to conduct a revenue requirement proceeding.

We believe there are also practical reasons for rejecting a temporary return to the 1995-2001 AFOR. It would be necessary for Verizon to reinstitute the price index (the Price Regulatory Index or PRI) that served as an overall rate cap and to make an "annual filing" to establish that its overall rate level (measured by the Actual Price Index or API) did not exceed that level. Under the 1995-2001 AFOR, it normally took Verizon about three months to prepare its annual filings. We fully intend to complete this proceeding within that period.

Alternative ending (to Part III) No. 1:

We decide to implement the pricing rules and SQI of the vacated AFOR on a temporary basis. It is the *de facto* status quo. Since the remand, Verizon has taken no action that would violate its terms. It has not argued that any of its provisions should not apply on an interim basis. Indeed, Verizon urges the

Commission to order that the "core principles" of the vacated AFOR will apply. Notwithstanding the Public Advocate's advocacy of an interim return to the 1995-2001 AFOR, he also appears willing to accept the pricing rules and SQI of the vacated AFOR during the interim. The OPA states that it:

> is willing to stipulate that the Service Quality Index (SQI) instituted by the *2001 AFOR Order* should remain in operation. We will also discuss with Verizon further stipulations that would put into place other features of the 2001 AFOR, including (a) caps on the rates for operator services and directory assistance, (b) pricing flexibility for optional services, and (c) pricing flexibility for retail toll.

In short, the Public Advocate has indicated a willingness to retain *all* of the features that we believe constitute the vacated AFOR.[1] The Public Advocate, of course, has a different view of what is included in the AFOR, arguing that the $1.78 increase to local rates that offset access revenue losses in 2001 is integral to the AFOR, and that it should not remain in effect. As discussed below, however, we find that the $1.78 increase is separate from the AFOR.

We therefore conclude that it is most reasonable to require Verizon to comply with the central features of the vacated AFOR as outlined below:

- A cap on local rates, subject to certain possible increases, external to the AFOR, for changes to basic service calling areas (BSCAs),

[1] The AARP has not expressed an opinion on this issue.

for the possible elimination of rate groups[2], and for further required access rate reductions,[3]

? Caps on operator services and directory assistance rates;

? Pricing flexibility for retail toll;

? Pricing flexibility for optional services;

? The ability, with Commission approval, to change rates for exogenous changes; and

? The Service Quality Index.

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[2] Under the BSCA Rule, Chapter 204, the Commission could order an increase in local rates in conjunction with expanding a BSCA. Pursuant to recent amendments to the BSCA rule, all BSCAs will include all contiguous exchanges. That expansion is not expected until December, 2003, which will be after the interim period in this case. If the Commission allows Verizon to eliminate rate groups, that event would probably occur at the same time as the BSCA expansion. Any elimination of rate groups would be on a revenue-neutral basis, so that rates for rate groups with smaller calling areas would increase and those for rate groups with larger calling areas would decrease.

[3] We discussed this possibility in the *2001 AFOR Order* at 18-19. We noted that future expected access rate decreases are likely to be much smaller than the 2001 decrease, that "their size may raise questions about whether they should be considered exogenous and subject to a pass-through in rates," and that Verizon was free "to decide whether it should seek to justify, under the rules of the revised AFOR, any changes to basic rates based on the 2003 access reductions." Recent changes to 35-A M.R.S.A. § 7101-B (effective on May 2 , 2003 pursuant to emergency legislation enacted by P.L. 2003, ch. 101) moved the next absolute deadline for reducing intrastate access rates to interstate levels to May 31, 2005, although the Commission has some discretion to order parity by an earlier date. **Examiner's note:** At its deliberations on May 37, 2003, the Commission will consider a draft MAINE PUBLIC UTILITIES COMMISSION, DOCKET NO. 2003-358, Investigation, Consideration of Notice of Investigation (of Verizon's compliance with amended 35-A M.R.S.A. § 7101-B) and Order to File Access Reduction Plan.

Alternative ending (to Part II) no. 2:

Examiner's Note: This ending to Part II depends on agreement by Verizon. Verizon may address this matter in its exceptions or responsive comments to this Examiner's Report.

Verizon [in its comments on the Examiner's Report] has stated that during the interim period, it will voluntarily abide by the price caps and the SQI of the vacated AFOR, refrain from increasing rates for toll or optional services and from any rate changes for exogenous effects. We view this as a reasonable resolution during the interim period. Verizon's agreement means that we do not need to order any specific form of regulation (or obtain the agreement of other parties) during the interim period. In short, Verizon will refrain from any rate activity that would require Commission approval, so that the actual status quo will apply. No person has any cause for complaint if, during that period, Verizon does not raise any of the described rates. Under this self-imposed interim regulatory regime, Verizon would:

- Not increase local rates, except for possible increases associated with changes to basic service calling areas (BSCAs), the possible elimination of rate groups[4], or further required access rate reductions;[5]
- Not increase rates for operator services and directory assistance;
- Refrain from increasing retail toll rates;
- Refrain from increasing rates for optional services;

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[4] *See* note 2 above.

[5] *See* note 3 above.

? Not change any rates for exogenous cost or revenue changes, except as permitted by the first paragraph in this list;[6] and

? Continue voluntarily to be subject to the provisions, including reporting requirements and sanctions, of the Service Quality Index ordered under the vacated AFOR.

III. THE $1.78 INCREASE TO LOCAL RATES TO OFFSET ACCESS REVENUE LOSSES

As proposed in the NFR, we decide that the increase in local rates of $1.78, ordered on June 1, 2001, will continue in effect. This increase was

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[6] The general ability to make rate changes for exogenous changes has been permitted by the Commission only as a feature of an AFOR or in conjunction with "stay-out" provisions in some rate stipulations. That ability is not well established in other contexts, particularly ROR regulation, where the policy against "single Issue rate cases" may apply. Under that doctrine, a utility cannot change rates to accommodate a major cost change without examining other changes in costs and revenues on the ground (at least under ROR) that it is not possible to ensure that rates are "just and reasonable" unless other costs and revenues are examined. *New England Telephone and Telegraph Company, Proposed Increase in Rates*, Docket No. 82-6, Order of Dismissal (May 11, 1982). (In that case NET proposed a rate increase to offset changes in depreciation rates, the expensing of station connections, and two wage increases.) Verizon's agreement to refrain from any rate activity that requires Commission approval avoids not only the needs to determine and to order a specific form of regulation during the interim period, but also any arguments about whether a rate change for an exogenous change could be permitted under the relatively formless "form" of regulation represented by Verizon's commitment.

On the other hand, rate changes for BSCA and access rate changes are permissible even without examination of other costs and revenues and regardless of the form of regulation. Both of these types of rate changes are revenue neutral, to offset changes in revenues that have occurred because of statutory legal requirements or orders of the Commission. Both types of changes have been specifically approved in decisions of the Law Court. *Public Advocate v. Public Utilities Commission*, 1998 ME 218, 718 A.2d 201; *OPA v. PUC/Verizon, supra.* Verizon is permitted to request rate changes for these reasons during the interim period, although that period should be long over before the addition of contiguous exchanges to BSCAs.

implemented for the purpose of offsetting access rate reductions required at that time by 35-A M.R.S.A. § 7101-B. The revenue effect of those access rate reductions continues on a permanent basis. We find that our decision to increase local rates to accommodate this revenue loss is separate from the AFOR and is not dependent on re-implementation of the AFOR. We do not agree with the arguments of the Public Advocate and AARP that the Law Court's vacation of the June 1, 2001 AFOR order precludes us from ordering a continuation of this rate increase.[7]

The Court explicitly ruled that Commission "acted within its discretion in allowing Verizon to increase its basic service rates," relying on past case law. 2003 ME 23, ¶1 and n.2. Nevertheless, the Court also vacated the "order creating the alternative form of regulation," and it is that order that contained the decision to allow Verizon to increase its basic service rates. The Court did not explain why it simultaneously approved the Commission's decision to allow Verizon to increase local rates to offset access revenue losses and reversed the very order that ordered the increase.

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[7] We also do not agree with Verizon's procedural argument that the Public Advocate has waived this issue because, after being informed in an e-mail from the Commission that it did not believe that the $1.78 increase had been reversed, the Public Advocate did not seek clarification from the Law Court. We are not aware of any doctrine, and Verizon cites none, that would require a party to take such an action in order to preserve arguments before and administrative agency about the interpretation of an appellate court's opinion following a remand to the agency.

Because we agree with the result argued by Verizon, we do not find it necessary to reach Verizon's arguments contained in Part I.B.2 of its brief.

We do not believe that Court's decision is as free from ambiguity as Verizon's brief suggests.[8] The fact alone that the Court upheld the Commission's discretion to order the local rate increase and simultaneously reversed the order creates a degree of ambiguity.

Nevertheless, on balance, we believe the Court did not intend to rule that the local rate increase was an integral part of the AFOR ordered by the Commission, or that it was necessary to reverse the $1.78 increase because it was necessary to vacate the order creating the AFOR, or that the increase could be ordered only in conjunction with the establishment of a new AFOR.[9] The Court provided no indication that it considered the local rate increase to be an integral part of or dependent on the AFOR. Footnote 2 of the Court's opinion recognizes the Commission's authority to order, or refuse to order, a basic rate

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[8] Verizon argues:

> …the Law Court took care to separately consider and explicitly address the increase in Verizon Maine's rates that was collateral to the Commission's adoption of the renewed AFOR. The Court's decision could not be more clear on this point.
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> …
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> While the Court's opinion vacates and remands to the Commission its AFOR orders for non-compliance with Section 9103(1), that section of the statute – *as the Law Court expressly determined* – has nothing to do with the $1.78 adjustment in rates. (Emphasis added).

We are unable to find such an express determination.

[9] The OPA's present position is somewhat at odds with the position it took in the AFOR proceeding, where it objected to "incorporation of the May 2001 access change into this proceeding." *2001 AFOR Order* at 16.

change in connection with enforcing the access parity statute, 35-A M.R.S.A. § 7101-B, despite the existence of an AFOR (which the Court characterized as generally precluding rate changes except pursuant to the pricing rules of the AFOR).[10] There is no reason to believe the Commission would not have the same or greater discretion under non-AFOR regulation.[11]

The Court made very clear that its reasons for vacating the AROR Order were because of the deficient finding under 35-A M.R.S.A. § 9103(1); it did not

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[10] Footnote 2 of the Court's opinion states:

> Generally, a utility subject to an AFOR is precluded from returning to the Commission for relief if its costs are high or profits low. In *New England Telephone & Telegraph Co. v. Public Utilities Commission*, 1997 ME 222, ¶ 7, 705 A.2d 706, 708-09, NYNEX appealed from a Commission order amending its rules to implement the Access Parity Statute, 35-A M.R.S.A. § 7101-B (Pamph. 2002), and mandating that Verizon reduce its intrastate access charges by twenty percent, without offsetting charges to make the order revenue neutral. We recognized the broad authority of the Commission, and concluded that the 1995 AFOR reserved to the Commission the power to issue such an order. Title 35-A M.R.S.A. § 7101(2) (Pamph. 2002) [sic; citation should be to 35-A M.R.S.A. § 104] provides that the Commission has "all implied and inherent powers under the Title which are necessary and proper to execute faithfully its express powers and functions." *In order to comply with section 7101-B, the Commission has the authority to order a reduction in access fees charged by NYNEX. It likewise has the authority to allow Verizon to offset some of its losses resulting from the reduced access fees*. *New England Tel. & Tel. Co.*, 1997 ME 222, ¶ 7, 705 A.2d at 708-09.

2003 ME 23, n.2 (emphasis added).

[11] The broad authority recognized by the Court in the second half of its Footnote 2 (quoted in full at footnote 10 **[chk no.]** of this Order) would not appear to depend in any way on the existence of an AFOR.

reverse because of a lack of authority to order an increase to local rates to offset required access rate decreases. The Court stated:

> *because* we agree, in part, with the Public Advocate that the *Commission failed to fully comply with section 9103(1)*, we vacate and remand to the Commission for further proceedings."

2003 ME 23 at ¶ 1 (emphases added). In addition, as pointed out by Verizon, the Court's "entry" reads: "Order *creating the alternative form of regulation* vacated. Remanded to the Commission for further proceedings consistent with this opinion (emphasis added)."[12] It is surely consistent with the Court's opinion to order a continuation of the local rate increase without regard to what happens with the AFOR. As the Court's opinion states, "the Commission *acted within its discretion* in allowing Verizon to increase its basic service rates (emphasis added)."

The Public Advocate argues:

> The Commission does not have the authority to set local rates at the start of an AFOR by adjusting those rates to account for one issue to the exclusion of all others. That is the essence of the Law Court's remand decision.

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[12] The Court also characterized the appeal as from (and arguments to vacate as applicable to) "orders" (plural) of the Commission "relating to the establishment of an 'alternative form of regulation' (AFOR)…for Verizon New England, Inc., and allowing Verizon to increase its basic service rates." In its "entry" the Court vacated the "order" (singular) "creating the [AFOR]." While we do not place substantial weight on the Court's possible differentiation between singular and plural, it may provide some indication that the Court viewed these issues as separate.

We do not agree. We believe the Court made abundantly clear that the Commission's authority to order an increase to local rates to offset required access rate decreases is not dependant on conducting a comprehensive rate proceeding, but is in fact independent, and can be ordered at any time, without the need to consider other issues.[13]

We also see nothing in the Court's opinion that would support the Public Advocate's argument (Brief p. 3) that:

> …the Law Court's earlier ruling does not apply here. The previous decision correctly held that a rate adjustment *during the term of an AFOR* is not always legally precluded. … [I]t did not, and could not, hold that an adjustment made in a materially rewritten AFOR Order is not subject to the express textual terms and conditions of the AFOR statute.

Nothing in the Court's language suggests that the Commission's authority to order an increase to rates is limited to the middle of an AFOR. If the Court had intended such a limitation, it would have distinguished the previous circumstance from the present, rather than stating that the Commission "acted within its discretion" in ordering the increase and (in footnote 2) emphasizing the broad and inherent authority of the Commission, in the course of implementing the access parity statute, to order a local rate increase. 2003 ME 23, ¶1, n. 2. The Court also would not have emphasized the Commission's authority *notwithstanding* the existence of the AFOR pricing rules if it intended to rule that

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[13] *See* discussion of "single-issue" ratemaking, and exceptions, at n. 6. **[Chk no.!]**

ordering a rate increase (to offset access revenue loss) that happened to coincide with the implementation of a revised AFOR was actually *dependant* on the validity of the order creating the AFOR. That the original AFOR expired and 35-A M.R.S.A. § 7101-B required Verizon to reduce access rates on essentially the same date was merely coincidental and does not logically tie the two events together. Ironically, The Public Advocate concedes that it is lawful to allow a revenue-neutral rate increase in the middle of an AFOR; the Public Advocate advocates a temporary return to the 1995-2001 AFOR, under which any rate change (including even a mandated access rate reduction) could be implemented on a revenue-neutral basis;[14] yet the Public Advocate apparently believes that such a revenue-neutral increase is not possible when a mandated access reduction and the beginning of an AFOR coincide.

The Court also provided no indication that the Commission could order the local rate increase only in conjunction with the reestablishment of the AFOR. Such a conclusion is even more unlikely than the conclusion that the increase was an integral part of the vacated AFOR. The Court clearly recognized the Commission's obligation to enforce the access parity statute. 2003 ME 23 n. 2. Enforcement of the access parity statute, and the Commission's discretion and inherent authority (recognized in 35-A M.R.S.A. § 104 and in footnote 2 of the Court's opinion) cannot possibly depend on the existence of an AFOR. If that

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[14] *See* note 15 **[Chk no.]** below.

were the case, the Commission could not require any other local exchange carrier in the state, besides Verizon, to comply with the access parity statute.

In ruling that the Commission acted within its discretion in this case, the Court relied on its own prior decision in *New England Telephone and Telegraph Co. d/b/a NYNEX v. Public Utilities Commission,* 1997 ME 222, 705 A.2d 706. In that case, the Court upheld the Commission's discretion to adopt and enforce (against NYNEX) a provision in Chapter 280, § 8 that required local exchange carriers to reduce access rates by 20 percent. The Chapter 280 requirement was unrelated to any other proceeding, including the existing Verizon AFOR.

The Commission also opened another proceeding in 1997 that was independent from any other proceeding to address the need, in 1999, for Verizon to comply with the access parity statute, 35-A M.R.S.A. § 7101-B.[15] In that proceeding, notwithstanding the AFOR pricing rule that effectively precluded increases to local rates, the Commission accepted a Stipulation that resulted in a $3.50 increase in local rates to offset access revenue losses.[16]

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[15] *Maine Public Utilities Commission: Proposed Amendment to Chapter 280 to Achieve Parity With Interstate Access Rates by May 30, 1999*, Docket No. 97-319, Notice of Rulemaking; Notice of Inquiry (June 10, 1997).

[16] The result was related to the AFOR only because it was necessary to waive the local rate pricing rule discussed in the text. Although the $3.50 increase did not cover all of the access revenue loss, under the operation of the AFOR's overall price cap (the PRI), any rate reduction, required or voluntary, could be (and nearly always was) implemented on a revenue-neutral basis.

Because of these prior cases, and the Law Court's ruling in this case, we have no doubt that we may lawfully order a revenue-neutral change in local (or any other) rates to offset a legally-required changes in access rates, and that we can do so independently of other, more general rate proceedings or of an AFOR proceeding.

The NOI raised a more specific question about the possible "integration" of the local rate increase with other pricing decisions in the AFOR Order, in particular, the decisions that Verizon would not be permitted to recover expected retail toll revenue losses through a local rate increase and that the retail toll losses would substitute for a formal productivity factor.[17] The AARP argues that because of this integration, it is necessary to vacate the local rate increase.

As indicated in the NOI, the retail toll and productivity decisions were, in part, an attempt to balance the competing interests. Although we do not believe the Court ruled that the local rate increase was integral to the AFOR, nevertheless, on our own, we could decide that the decision to order an increase

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Thus, the access revenue loss was made up by the $3.50 local rate increase and by other rate increases.

[17] The Public Advocate's brief mentions another "integrating" factor, our finding in the 2001 AFOR Order that "allowing Verizon to increase its basic rates *by only a portion* of the amount necessary to offset the revenue losses from mirroring interstate access charges" partially satisfied the seventh objective in 35-A M.R.S.A. § 9103 (that the AFOR must "encourage the development, deployment and offering of new telecommunications and related services"). This "integration" is substantially less important than the pricing decisions discussed in the text.

to local rates was so connected to other decisions in the AFOR order that it is not appropriate to allow Verizon to retain the increase, at least while we reconsider whether we can reinstitute the AFOR on a permanent basis. We decline to do so. In the first place, as discussed above, while "balancing" played a role in the decision to allow Verizon to increase its local rates, the decision was also driven by the facts of the significant revenue loss itself and that Verizon had little control over the loss, which was mandated by statute. Indeed, as AARP points out, we treated the increase essentially **[chk]** as "exogenous," within the meaning of that term as defined in the 1995 AFOR Order.

If these three decisions (along with the mandated toll rate or toll revenue loss of $19.2 million) are truly interdependent, in fairness it might be necessary to vacate all of them during the interim period while we consider whether we may implement an AFOR. The AARP's brief does not suggest such action, and we doubt that either AARP or the Public Advocate would willingly forego the other three decisions in order that the local rate increase be rescinded, possibly only temporarily. Even if either of those parties would prefer that trade-off, for the reasons explained in Part III above, we believe that maintaining the *status quo* make more sense during the interim period.

In arguing that the Commission must conduct some form of revenue requirement determination before we can order a continuation of the $1.78 increase to local rates, the Public Advocate claims that:

> Section 9103(1) requires that the Commission compare two sets of local rates: the rates that will go into effect under the AFOR that is being

> contemplated, and the rates that would be determined in a traditional rate-of-return proceeding. An ROR analysis, by its very nature, requires a bottom-up determination of a cost-based rate for local service. Under rate-of-return (ROR) regulation, the "lost" access revenues may well be offset -- in whole, or in part -- by increases in the Company's other revenues, or by reductions in the Company's expenses, or costs of capital -- in which case the Commission could *not* then necessarily include the full (or any) amount of the $1.78 increase in the rates to be in effect for the new AFOR. [Footnote omitted]

The Public Advocate's argument indicates a lack of understanding of the ratemaking process in an ROR proceeding. If we were to conduct such a proceeding, and used the resulting revenue requirement as the basis for rates, including local rates, the Public Advocate is undoubtedly correct that it is unlikely that the final change in rates would be $1.78 because of other changes in revenues and costs.[18] AARP makes a similar argument: it states the Commission made a determination that "that productivity gains and increases in revenue for other services might not be high enough to offset access revenue reductions," and that the Commission should now use the "immediate historical record."

The Public Advocate is incorrect, however, to the extent it may be suggesting that the full $1.78 would not be included in the final rate, whether under ROR or an AFOR. In an ROR determination, the access revenues that were lost due to the May 30, 2001 access rate reduction (required by law) would

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[18] We recognized this aspect of the ratemaking process in the NFR at n. 6.

simply be missing from test year (presumably 2002) revenue.[19] After determining a utility's revenue requirement (costs) in an ROR proceeding, the Commission must set rates that, at least initially, will produce revenues equal to those costs. To attain this initial balance, other revenues must replace the lost access revenues. The access revenues would not be offset by an increase to some other rate only if a party were to successfully argue that Verizon acted imprudently in losing the revenues. The likelihood of such an argument succeeding is extremely small, given that Verizon was required by law to reduce its access rates. Indeed, in arguing that the lost revenues might be offset by other revenue and cost factors, the Public Advocate virtually concedes that they must be offset.[20]

What the Public Advocate's argument fails to recognize is that, if all of the other revenue and cost factors, after their determination in the revenue requirement – revenue process, were held constant, Verizon's rate(s)[21] must be

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[19] A 2002 test year would contain the lower (post-decrease) level of access revenues for the entire year. Even if the test year were 2001, access revenues would be adjusted to reflect ongoing levels.

[20] The Public Advocate argues that the lost revenues could come from either increased sales from other services or that the need to replace them could be diminished because of reduced costs. It is also possible, of course, that an ROR proceeding would show opposite effects, so that it would be necessary for rates to increase by amounts greater than the amount necessary to offset the access revenue loss.

[21] For the reasons explained in the *2001 AFOR Order*, it is nearly impossible to increase any rate other than local rates.

higher, by approximately $1.78 per month,[22] than they would otherwise be in the absence of the access revenue loss.

Similarly, if we ultimately order an AFOR in this post-remand proceeding, it is most likely that the local rates under that AFOR would include an amount that offsets the access revenue loss that began on June 1, 2001. (Under an AFOR, we might actually have more discretion than under ROR regulation to order that any given revenue loss not be passed through in other rates.)[23] Under the 1995-2001 AFOR (the Public Advocate's preferred alternative for interim regulation) Verizon could make up any revenue loss (including form access) by increasing other rates, subject to the overall rate cap.[24]

Because of the high likelihood that the 2001 access revenue loss will be offset in any future (post-proceeding) local rates, we conclude that it is appropriate, as matter of sound ratemaking policy, for local rates to continue at

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[22] The $1.78 was calculated based on Verizon's estimates of access loss, offset by our estimate of a growth in access sales of about 20%. **[chk AFOR order]** In an actual ROR proceeding, we would most likely use actual access revenue loss.

[23] In the vacated AFOR order, we stated that we would apply the standard applicable to exogenous changes to a request by Verizon to offset further access reductions that 35-A M.R.S.A. § 7101-B (prior to its recent amendments in P.L. 2003, Ch. 101) would have required on May 30, 2003.

[24] Under that AFOR, to increase local rates, it would be necessary to grant a waiver to the pricing rule that local (as well as retail toll) rates could not increase unless the price index (PRI) was positive. We granted such a waiver for the $3.50 increase in local rates that was necessary to offset the 1999 access rate reduction required by 35-A M.R.S.A. § 7101-B.

the same level as we ordered in June of 2001, i.e., to include an amount that offsets the access revenue loss that began on June 1, 2001. Under any plausible regulatory alternative (ROR or AFOR) following the conclusion of these proceedings, that amount will be included in going-forward local rates.

Under an ROR determination that would then used for setting rates, the net change between local rates in effect just prior to June 1, 2001, and those following this proceeding may well be more or less than $1.78. It is by no means certain, however, that we will conduct a full rate proceeding. Such a proceeding may not be necessary either to establish a starting point for rates under ROR regulation or an AFOR, or for the purpose of making the comparison required by 35-A M.R.S.A. § 9103(1). The Court clearly stated that section 9103(1) does not require a full rate proceeding. 2003 ME 23 at ¶¶ 28-29. The kind of comparison allowed by the Court may, or may not, provide a specific determination of the net difference in rates (pre-June 2001 to post-proceeding) described above.

A continuation of the $1.78 increase in local rates is therefore a reasonable exercise of our ratemaking authority. As discussed above, we believe that the Court also determined that it is lawful, i.e., within the Commission's sound discretion and "inherent authority" to enforce the provisions of the access parity statute, 35-A M.R.S.A. § 7101-B.

Accordingly, we

O R D E R

1. That between the date of this Order and the completion of proceedings following the remand by the Supreme Judicial Court, Verizon shall be subject to interim regulation as described in Part III of this Order. [Language will be modified if Verizon opts for "Alternative 2" described in Part III.]

2. That the rate increase in rates for local exchange service of $1.78 (implemented in June of 2001 to offset access rate decreases and access revenue loss required by 35-A M.R.S.A. § 7101-B) shall remain in effect until further order.

Respectfully submitted,

Peter Ballou
Hearing Examiner

With: Richard Kania and
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